

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



July 17, 2003

Agenda ID #2490
Ratesetting

TO: PARTIES OF RECORD IN INVESTIGATION (I.) 02-11-040 AND I.03-02-033

This is the draft decision of Administrative Law Judge TerKeurst. It will not appear on the Commission's agenda for at least 30 days after the date it is mailed. The Commission may act then, or it may postpone action until later.

When the Commission acts on the draft decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Parties to the proceeding may file comments on the draft decision as provided in Article 19 of the Commission's "Rules of Practice and Procedure." These rules are accessible on the Commission's website at <http://www.cpuc.ca.gov>. Pursuant to Rule 77.3 opening comments shall not exceed 15 pages. Finally, comments must be served separately on the ALJ and the assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious method of service.

/s/ Angela K. Minkin
Angela K. Minkin, Chief
Administrative Law Judge

ANG: avs

Decision **DRAFT DECISION OF ALJ TERKEURST** (Mailed 7/17/2003)**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Order Instituting Investigation into the Gas Market Activities of Southern California Gas Company, San Diego Gas and Electric, Southwest Gas, Pacific Gas and Electric, and Southern California Edison and their impact on the Gas Price Spikes experienced at the California Border from March 2000 through May 2001.

Investigation 02-11-040
(Filed November 21, 2002)

Order Instituting Investigation whether San Diego Gas & Electric Company, Southern California Gas Company and their holding company, Sempra Energy, respondents, have complied with relevant statutes and Commission decisions, pertaining to respondents' holding company systems and affiliate activities.

Investigation 03-02-033
(Filed February 27, 2003)

**INTERIM OPINION MODIFYING OII IN RESPONSE
TO PETITION FOR MODIFICATION****I. Summary**

We grant in some respects the petition for modification filed by San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCal Gas) on March 12, 2003. We modify the Order Instituting Investigation (OII) initiating Investigation (I.) 03-02-033 to provide for an independent audit as the first step in this investigation. We will not schedule further action in I.03-02-033 until the audit is completed. In addition, we deconsolidate this proceeding from I.02-11-040.

II. Background

On February 27, 2003, we issued an OII initiating I.03-02-033 to evaluate the business activities of the respondent utilities, SDG&E and SoCal Gas, and their holding company, Sempra Energy (Sempra), to ensure that they have complied with relevant statutes and Commission decisions and rules in the management, oversight, and operations of their companies. The OII consolidated this Sempra affiliate investigation with I.02-11-040 examining market activities of California's regulated gas utilities and their impact on gas price spikes at the California border from March 2000 through May 2001.

SDG&E and SoCal Gas filed a petition to modify the OII on March 12, 2003. Southern California Edison Company (SCE) filed a response to the petition, and Utility Consumers' Action Network (UCAN) filed a motion requesting the late filing of its response to the petition, with its response attached to the motion. UCAN's motion is hereby granted. SDG&E and SoCal Gas replied to SCE's response on April 4, 2003.

During a prehearing conference (PHC) held on May 29, 2003, issues raised by the petition and the related filings were discussed along with other matters regarding the Sempra affiliate investigation.

III. Positions of the Parties

SDG&E and SoCal Gas ask that there be clarification regarding allegations of affiliate wrongdoing, that their existing annual audit of affiliate activities be used for fact-finding in I.03-02-033, that the procedural schedule be suspended pending the audit, and that I.03-02-033 be separated from I.02-11-040.

SDG&E and SoCal Gas assert that the OII is vague and general, and does not identify any actions by either them or their affiliates that might constitute a violation of any of the Commission's rules. On that basis, SDG&E and SoCal Gas

recommend that the OII be modified to direct the Chief Administrative Law Judge (ALJ) to identify any allegations of affiliate wrongdoing involving them that had been raised and deferred from a past proceeding.

SDG&E and SoCal Gas also recommend that the OII be modified to provide for an independent audit to assess their compliance with the Commission's various affiliate-related rules. The two utilities submit that an independent review of their compliance with the Commission's affiliate rules will provide a factual context and enable the Commission to identify any specific areas of concern. SDG&E and SoCal Gas recommend that the Commission direct the auditors to engage in fact-finding on the Commission's behalf with respect to any issues identified by the Chief ALJ.

SDG&E and SoCal Gas point to the annual audit of affiliate compliance ordered by the Commission in Decision (D.) 97-12-088,¹ with the audit for calendar year 2002 activities being conducted by the NorthStar consulting firm. The utilities submit that NorthStar would be ideally suited to assist the Commission and that the scope of the audit could be expanded for purposes of this investigation. They ask that the Commission relieve them of the requirement that the annual audit report be provided by May 1, 2003, to permit

¹ D.98-08-035, which modified D.97-12-088, made minor changes to the audit requirement.

NorthStar the time necessary to conduct additional fact-finding. They also request that the schedule of the investigation be suspended, including the scoping memo, procedural schedule, and discovery, pending completion of the recommended audit.

While SCE does not object to a fact-finding audit, it asserts that such an audit should not be separate from the annual year-specific audit required by D.97-12-088. SCE submits that an audit for purposes of I.03-02-033 should be designed to gather and analyze information on affiliate issues spanning several years.

UCAN suggests that SDG&E's and SoCal Gas' proposed reliance on the annual audit may not be feasible given the scope of the issues involved in this proceeding. UCAN contends that, rather than modifying the OII as SDG&E and SoCal Gas request, the Commission should hold a PHC, at which time parties could identify the issues that they believe warrant investigation. It submits that a PHC would assist in gauging how this proceeding should unfold.

SDG&E and SoCal Gas recommend that I.03-02-033 be separated from I.02-11-040 on the basis that consolidation potentially would be confusing and could delay the gas price spike investigation, for which testimony and hearing dates have been established. They state that, while I.02-11-040 will address the reasons for high gas prices in the California gas market during a 15-month period in 2000 and 2001, I.03-02-033 is intended to address potential areas of concern outside of California gas market price issues and outside this time period. In their view, separation would avoid confusion between the issues to be addressed in each investigation. UCAN concurs with SDG&E and SoCal Gas that the two investigations should be separated.

While not objecting to separation of the two proceedings, SCE cautions that such a step should not restrict either investigation. SCE submits that a

complete evaluation of border price spikes requires an examination of the possible exercise of market power by SDG&E, SoCal Gas, and their affiliates. SCE requests that SDG&E and SoCal Gas be prohibited from objecting in I.02-11-040 to the admission into evidence of information regarding Sempra affiliate activity. SCE also raises concerns about possible claims of confidentiality with respect to information on affiliate and utility gas transactions.

IV. Discussion

As UCAN suggested, discussions during the PHC along with the submitted PHC statements were helpful in our assessment of whether the requests in SDG&E and SoCal Gas' petition for modification are warranted. We find merit in the proposal that an audit be performed as a first step in the Sempra affiliate investigation, in order to provide an independent assessment of the companies' activities relevant to the investigation.

The scope of the independent audit should be broader than SDG&E and SoCal Gas have suggested, consistent with the scope of the investigation delineated in the OII. In addition to an evaluation of compliance with our current rules and requirements, we wish to assess the potential for conflicts between the interests of Sempra and the interests of the regulated utilities and their ratepayers,² and to examine whether business activities undertaken by the utilities and/or their holding company and affiliates pose potential problems or unjust or unreasonable impacts on utility customers.³ The audit should examine each of these areas. Because consumer interests go hand in hand with promoting competition, and consistent with the objectives of the existing affiliate transaction

² OII, *mimeo.*, at 3.

³ *Ibid.*, *mimeo.*, at 6.

rules,⁴ the audit should encompass potential conflicts of interest or activities that may be detrimental to competition.

There is value in the utilities' suggestion that the audit undertaken for this investigation be combined with the annual audit performed pursuant to D.97-12-088 and D.98-08-035. Such a combined effort could be more efficient and less costly than two separate audits. Since the calendar year 2002 audit has been completed, we provide that the audit for this investigation and the calendar year 2003 audit will be performed on a combined basis.

The utilities have commissioned and filed the annual audits pursuant to D.97-12-088 and D.98-08-035. For purposes of this investigation, the combined audit should be undertaken under the supervision of Energy Division and performed pursuant to Public Utilities Code § 797.⁵ We direct Energy Division to contract directly with the auditor with payment from Commission accounts. SDG&E and SoCal Gas shall reimburse the Commission for all amounts expended for the audit.

With the adoption of an independent audit, we see no need to grant SDG&E and SoCal Gas' request that the Chief ALJ be required to itemize instances in which affiliate-related concerns have been raised in past proceedings.

Further action in the investigation should not be scheduled at this time pending completion of the audit. Upon completion, Energy Division will file the audit report and shall serve the audit report, or a notice of availability of the

⁴ See, D.97-12-088, 77 CPUC2d 422, 449-450.

⁵ All code section references are to the California Public Utilities Code unless otherwise noted.

audit report, on the service list for this proceeding. A second PHC will then be held to discuss the scope and procedural schedule of the investigation based on audit results.

We agree that this investigation should be separated from the gas spike investigation because of the divergence of their schedules and the limited scope of potential overlap in the two investigations. Neither investigation is restricted by our decision to separate them. We recognize that information regarding actions by SDG&E, SoCal Gas, their holding company, or their unregulated affiliates that may have affected gas prices during the period addressed by the gas spike investigation may be relevant to both investigations. However, it is premature to address at this time the admissibility of such information in either investigation.

Upon separation, the service list for each investigation will be the combined service list created at the May 29, 2003 PHC. However, the service list for each investigation will be maintained separately thereafter.

SCE's concerns regarding possible claims of confidentiality are raised prematurely in its response to the petition for modification. SCE may pursue such claims through established procedures for resolution of discovery disputes.

V. Comments

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g)(1) and Rule 77.7 of the Rules of Practice and Procedure. Comments were filed on _____ and reply comments were filed on _____.

VI. Assignment of Proceeding

Commissioner Geoffrey F. Brown is the Assigned Commissioner and Charlotte F. TerKeurst is the assigned ALJ in this proceeding.

Findings of Fact

1. The petition for modification complies with the procedural requirements of Rule 47 of the Rules of Practice and Procedure.

2. It is reasonable to require an audit as the first step in this investigation, in order to obtain an independent assessment of the companies' activities relevant to the investigation.

3. SDG&E and SoCalGas' request that the calendar year 2002 audit be expanded to encompass the scope of this investigation is now moot.

4. It is reasonable to combine the audit for purposes of this investigation with the calendar year 2003 audit required by D.97-12-088 and D.98-08-035, in order to improve efficiency and reduce costs.

5. With the adoption of an independent audit, there is no need to require that the Chief ALJ itemize instances in which affiliate-related concerns have been raised in past proceedings.

6. It is reasonable to separate I.03-02-033 and I.02-11-040 because of the divergence of their schedules and the limited scope of potential overlap in the two investigators.

7. Information regarding actions by SDG&E, SoCal Gas, or their affiliates that may have affected gas prices during the period addressed by the gas spike investigation may be relevant in both I.02-11-040 and I.03-02-033. However, it is premature to address at this time the admissibility of such information in either proceeding.

8. SCE's concerns regarding possible claims of confidentiality are raised prematurely in its response to the petition for modification.

Conclusions of Law

1. The petition for modification should be granted to the extent discussed herein.
2. The OII initiating I.03-02-033 should be modified as described herein to provide for an independent audit as the first step in the investigation and to separate the investigation from I.02-11-040.
3. SCE's requests regarding the admissibility of information regarding Sempra affiliate activity and the classification of information on affiliate and utility gas transactions should be denied.
4. This order should be effective today, in order to provide certainty to the parties and to promote an efficient use of their resources and the resources of the Commission.

INTERIM ORDER**IT IS ORDERED** that:

1. The Petition for Modification filed on March 12, 2003 by San Diego Gas & Electric Company and Southern California Gas Company is granted to the extent described herein and is denied in all other respects.
2. The Motion for Leave to Accept Late Filing of Comments by the Utility Consumers' Action Network is granted.
3. The following paragraphs are added after the partial paragraph at the top of Page 6, *mimeo.*, of Investigation (I.) 03-02-033:

"An independent audit should be performed as the first step in this investigation, in order to assess the compliance of SDG&E, SoCal Gas, and Sempra with relevant statutes and the Commission's affiliate transaction rules and whether the companies' business activities have posed potential problems or unjust or unreasonable impacts on utility customers. Because consumer interests go hand in

hand with promoting competition, and consistent with the objectives of our existing affiliate transaction rules, the audit should encompass potential conflicts of interest or activities that may be detrimental to competition. This audit should be combined with the calendar year 2003 annual audit to be performed pursuant to D.97-12-088 and D.98-08-035, in order to reduce costs and promote efficiency.

“This combined audit should be undertaken under the supervision of Energy Division and performed pursuant to § 797, with the selected auditor having full access to all information to the full extent provided by Law, including §§ 313 and 314 and Section IV.A of the merger conditions adopted in D.98-03-073. Energy Division shall contract directly with the auditor and payment shall be made from Commission accounts. SDG&E and SoCal Gas shall reimburse the Commission for all amounts expended for the audit.

“The auditor should review Sempra’s holding company and affiliate structure to identify any corporate relationships that may create potential conflicts between the interests of Sempra and the interests of the regulated utilities and their ratepayers. To assist in identification of possible areas of concern, the auditor should interview knowledgeable individuals and should review prior Commission orders, Federal Energy Regulatory Commission orders, past audits of affiliate transactions, and the affiliate-related concerns that parties have raised in this proceeding and in other proceedings.

“The auditor should gather and analyze information on activities since December 17, 1997, when the Commission adopted affiliate transaction rules in D.97-12-088. The auditors may review activities prior to the audit period if they believe it is necessary to fulfill the goals of the audit. The audit of compliance with the existing affiliate transaction rules should encompass 2003 activities (the calendar year 2003 audit), as well as activities in other years related to specific concerns that may be identified. In its audit report, the auditor should identify any areas and ways in which our affiliate transaction rules could be strengthened to prevent undesirable affiliate-related activities not addressed by the existing rules.”

4. The first paragraph on Page 6, *mimeo.*, of I.03-02-033 is modified as follows (text to be deleted is indicated in strikeover format):

~~“This proceeding will be consolidated with I.02-11-040, the gas price spike OII, due to the overlap with issues being addressed in Phase 1 of that proceeding.~~ The scope of this proceeding will include all issues raised in this order. Any party may suggest related issues for the Commission’s consideration. The present investigation is classified as a ratesetting proceeding and is expected to require a hearing.”

5. The following paragraph is added on Page 7, *mimeo.*, of I.03-02-033 following the second paragraph in Section V:

“Following completion of the combined audit, Energy Division shall file the audit report and shall serve the audit report, or a notice of availability of the audit report, on all parties to I.03-02-033. A second PHC will then be held to discuss the scope and procedural schedule of the investigation based on audit results. The assigned Commissioner will rule on the scoping memo for this proceeding, pursuant to Rule 6.3, after the second PHC.”

6. Ordering Paragraph 9 of I.03-02-033 is stricken.

7. The following ordering paragraphs are added to I.03-02-033:

- “11. Energy Division shall perform an audit that meets the purposes of this investigation and the calendar year 2003 audit required by Decision 97-12-088 and Decision 98-08-035, pursuant to Public Utilities Code § 797. The selected auditor shall have full access to all information to the full extent provided by Law, including Public Utilities Code §§ 313 and 314 and Section IV.A of the merger conditions adopted in Decision 98-03-73. Payment shall be made from Commission accounts.
- “12. San Diego Gas and Electric Company and Southern California Gas Company shall reimburse the Commission for all amounts expended for the combined audit including the fees and expenses of an outside auditor and Energy Division’s incremental travel costs, if any.
- “13. Because of the combined audit, the requirement in Decision 97-12-088 and Decision 98-08-035 that each utility have an annual audit performed is waived for calendar year 2003 for San Diego Gas & Electric Company and Southern California Gas Company.
- “14. Following completion of the combined audit, Energy Division shall file the audit report and shall serve the audit report, or a notice of availability of the audit report, on all parties to Investigation 03-02-033. Energy Division shall provide a copy of the audit report to the assigned Commissioner, the assigned Administrative Law Judge, San Diego Gas & Electric Company, and Southern California Gas Company. Energy Division shall provide a copy of the audit report to any party who requests a copy.
- “15. After the combined audit report is filed, a second prehearing conference shall be scheduled at a date and time to be determined by the assigned Administrative Law Judge for the purpose of addressing the scope and further schedule of the investigation and other procedural issues. Interested persons may file prehearing conference statements as directed by the Administrative Law Judge, addressing issues to be considered and the proposed schedule. Service shall be made on the service list established at the first prehearing conference.”

8. The requests of Southern California Edison Company regarding the admissibility of information pertaining to Sempra Energy affiliate activity and the classification of information on affiliate and utility gas transactions are denied.

9. I.02-11-040 and I.03-02-033 are deconsolidated. Upon separation, the service list for each of the two investigations shall be the combined service list created at the May 29, 2003 prehearing conference. The service list for each investigation shall be maintained separately thereafter.

This order is effective today.

Dated _____, at San Francisco, California.